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SIPDIS

SENSITIVE

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11. (SBU) SUMMARY: Nova Scotia and Newfoundland have been working to streamline their regulatory regimes for offshore energy exploration, but industry calls for combining the two federal-provincial offshore boards will not be acted upon any time soon. The Premiers of Nova Scotia and Newfoundland and Labrador are both pushing hard for a better deal on energy royalties from offshore production: Paul Martin says he's considering the plan while Stephen Harper has already said he agrees with it. The relatively slow pace of exploration offshore Nova Scotia is dramatically illustrated by the presence of two jack-up drilling rigs in Halifax harbor. Irving Oil Company is moving ahead with plans for a liquefied natural gas terminal near St. John on the Bay of Fundy, action that may preclude development of an LNG facility in Nova Scotia. Newfoundland and Labrador's Premier is keen to press ahead with the Lower Churchill Falls hydroelectric development, but he would like to minimize Quebec's participation in the project. New Brunswick Power and the provincial energy ministry have come under stinging criticism for mishandling the conversion of a power plant to allow it to burn bitumen-based "orimulsion" fuel from Venezuela. END SUMMARY.

PUSH TO STREAMLINE OFFSHORE REGULATIONS ...

12. (SBU) Both Nova Scotia and Newfoundland and Labrador government officials have said that they are looking for ways to streamline and make more transparent regulations regarding offshore energy exploration. Nova Scotia, in particular, is concerned that the pace of offshore exploration has fallen (see para 5 below), with a resulting slowdown in support industry work and revenues. NS Energy Minister Cecil Clarke and his Deputy Minister Dan McFadyen have come to the conclusion that they need to do a better job of selling the province's offshore potential to the energy industry, particularly to U.S. firms. Clarke plans trips to major offshore energy shows and Washington to meet with the industry and U.S. regulators to draw attention to what Clarke call's the province's "steady, go-forward plan" for offshore development.

13. (SBU) Streamlining, however, will probably not extend to combining the two federal-provincial offshore energy boards, as many in the industry have called for. Premier Danny Williams in St. John's was categorical that his government saw no advantage to a combined board, something Fred Way, vice-chairman of the Canada-N-L board, confirmed with CG recently. In practice, differing rules in the two jurisdictions add inefficiencies to the hunt for energy in Atlantic Canada's offshore areas, but neither province wants to suffer the potential job losses in support industries that combining the boards and rationalizing their rules would entail. N-L's level of offshore activity is much higher right now than Nova Scotia's, so St. John's perceives that it has the most to lose by creating a single joint offshore board.

... AND KEEP MORE OF THE REVENUES

14. (U) Newfoundland and Labrador Premier Danny Williams and his Nova Scotia counterpart John Hamm are leading the charge for a new deal with Ottawa that would give the provinces a larger share of the royalties. A key issue will be whether the federal government "claws back" equalization payments if offshore royalties rise -- as things currently stand the provinces lose 70 cents of equalization for every additional dollar of offshore revenue they collect. Williams, in particular, has made re-negotiation of the Atlantic Accord a top priority and told CG that he has tried hard to cultivate a relationship with PM Paul Martin to advance this and other provincial goals. Martin said recently during a visit to Nova Scotia that he was considering changing the formula; Conservative Party leader Stephen Harper beat him to the punch by announcing that he supports increased royalties with no clawback.

RIGS IN THE HARBOR

15. (U/PROPIN) One indication of the relatively slow pace of exploration in Nova Scotia's offshore in recent months is that there are now two jack-up drilling rigs parked in Halifax harbor between jobs. GlobalSantaFe's "Galaxy II," designed and built

specifically to work in this region, has been in port since November 2003 after about five years of drilling in the relatively shallow waters around Sable Island. Rowan's "Gorilla V" joined its competitor in the harbor in March. There is currently only one rig working in Nova Scotia's offshore, but both GSF and Rowan tell us they expect to be back out by June. Keeping a rig in port for prolonged periods is a costly proposition: GSF told us that they spend US\$60-70,000 per day keeping the "Galaxy II" at the dock; when the rig is working it can be billed at 10 to 15 times that amount.

LNG: NEW BRUNSWICK STEALING A MARCH ON NOVA SCOTIA?

16. (SBU) As reported in reftel, Irving Oil Ltd. is moving forward with plans for a liquefied natural gas (LNG) plant near St. John, New Brunswick, on the Bay of Fundy. Senior NB energy official recently told CG that Irving delivered its environmental impact statement for the plant to the NB government in mid-March, and that the area proposed for the plant had been set aside for industrial development. Irving, they said, was "very serious" about LNG. This is probably bad news for the firm ANE, which is proposing to build an LNG facility near Port Hawksbury, NS. A Nova Scotia cabinet member who represents the area told CG in fall 2003 that a cabinet decision and announcement about the project would be made before Christmas, but it does not seem to have materialized yet. COMMENT: There is a good case to be made for one LNG plant in the area in the medium term, but it is hard to see how two could make economic and financial sense. Whichever group gets going first will probably win. END COMMENT.

#### LOWER CHURCHILL HYDROELECTRIC DEVELOPMENT

17. (SBU) Newfoundland and Labrador Premier Danny Williams told CG during a recent trip to St. John's that his government was committed to development of the Lower Churchill Falls hydroelectric power project. Williams clearly would love to find a way to push the project forward without involving Quebec, perhaps by cutting a deal directly with U.S. electricity consumers that would permit financing for the project. Unfortunately, geography seems to make a deal with N-L's neighboring province inevitable, since there seems to be no realistic way to send electricity to the U.S. without using Quebec's lines or building new ones that pass through the province.

18. (SBU) COMMENT: The existing deal with Quebec for Upper Churchill Falls electricity is widely seen in N-L as a textbook example of poor negotiation, so it is not all that surprising that Williams would love to gain the near-universal acclaim in the province that would follow a Lower Churchill deal which somehow managed to exclude Quebec. Interestingly, one of the justifications offered for the multi-billion dollar proposed rail tunnel under the Strait of Belle Isle that would link Newfoundland to the Labrador mainland is that the tunnel could be used to house electric transmission lines. END COMMENT.

#### WHAT WERE THEY THINKING?

19. (SBU) And finally, in New Brunswick, a committee of the legislature is pondering what to do about the orimulsion scandal after hearing hours of testimony from provincial officials. The short version of this story is that NB Power, which has worked with a Venezuelan firm for more than 15 years on ways to use the bitumen-based fuel and has had one power plant burning orimulsion for a decade, went ahead with C\$600-700 million worth of renovations on another plant to allow it to burn orimulsion. Unfortunately, there was apparently nothing but a handshake deal to provide fuel to the second plant, and the supplier has recently decided that there are more profitable things to do with orimulsion than ship it to New Brunswick. Provincial energy officials told CG that about half of the modifications to the plant were emissions control and other upgrades that were needed regardless of the type of fuel, but that about C\$350 million would be wasted if indeed the plant had to be converted to burn something other than orimulsion. News of mismanagement on such a scale comes at a bad time for the province: the budget is tight, civil service salaries are frozen and services are being cut back.

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